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C O N F I D E N T I A L SECTION 01 OF 02 SAN SALVADOR 003544

SIPDIS

USDOC FOR 4332/ITA/MAC/MSIEGELMAN
USDOC FOR 3134/ITA/USFCS/OIO/MKESHISHIAN/BARTHUR

E.O. 12958: DECL: 12/20/2015
TAGS: EINV PGOV ECON ES
SUBJECT: APPEALS COURT AWARDS FORMER MCDONALD'S FRANCHISEE $24 MILLION

REF: A. SAN SALVADOR 3505

¶B. 2003 SAN SALVADOR 1955

Classified By: A/DCM Mark Silverman. Reason 1.4 (D).

¶1. (SBU) Summary: In an unexpected twist in McDonald's ten-year legal battle with former franchisee Servipronto, the Second Court of Appeals ruled on December 7, 2005, that the U.S. fast-food giant had illegally terminated its franchising agreement with Servipronto on July 1, 1996, and therefore owed the local firm $24 million in damages for unrealized earnings during what would have been a 20-year extension, to June 30, 2016. One other case involving McDonald's and Servipronto has been resolved in favor of McDonald's, while two others are unresolved. The Salvadoran Courts are inefficient, politicized, and occasionally corrupt. Their inability to effectively enforce commercial law detracts from the country's ability to attract investment. Post will continue to encourage the Government of El Salvador to press for meaningful judicial reform. End summary.

¶2. (U) The Second Court of Appeals ruled on December 7, 2005, that McDonald's had illegally terminated its franchising agreement with Salvadoran franchisee Servipronto on July 1, 1996, and therefore owed the local firm $24 million in damages for unrealized earnings during what would have been a 20-year extension, to June 30, 2016. Servipronto's president, Roberto Bukele, originally filed this case against McDonald's in the Fourth Mercantile Court in February 1997, alleging that McDonald's had agreed to extend his franchise agreement in a letter agreement dated April 27, 1994. The letter agreement states that licenses for two restaurants "would be re-written upon their expiration for new 20-year terms provided they are remodeled to comply with McDonald's current standards." The letter agreement also required Bukele to close one restaurant operated at a location (Metrocentro) not approved by McDonald's and required him to use only approved suppliers of goods and services. McDonald's claimed that Bukele did not live up to the terms of the letter agreement (for example, he did not remodel, did not close the outlet in question, and continued to use unauthorized suppliers), and on July 10, 1996, McDonald's notified Bukele that his right to be a McDonald's license had expired as of July 1.

¶3. (U) The Fourth Mercantile Court ruled in favor of McDonald's in May 1997, stating that there was no franchise agreement because Bukele had not lived up to the terms of the April 27, 1994 letter agreement. Bukele appealed the case to the Second Court of Appeals, which in January 2000 affirmed the lower court's decision. Bukele then appealed the case to the Supreme Court's Civil Chamber, which ruled in February 2003 that the Second Court of Appeals should hear the case again to allow Bukele to submit new evidence (financial data). McDonald's local counsel has told Emboffs that before the January 5, 2006, deadline for doing so, the company will appeal the December 7, 2005, ruling to the Civil Chamber of the Supreme Court. McDonald's would not be required to pay the $24 million fine while the case were pending before the Civil Chamber. Whichever party loses the case would likely file a final appeal that would be heard by the Constitutional Chamber of the Supreme Court.

¶4. (C) McDonald's local counsel is concerned that the case will not receive a fair hearing in the Civil Chamber. Although judges are subject to possible reassignment in January 2006 within the court's different chambers, local counsel believes two of the judges currently serving in the Civil Chamber would likely recuse themselves from the case based on previous involvement, while a third judge is a former FMLN guerilla with a strong bias against U.S. interests. If she or the other judges are reassigned in January, there is no guarantee the Civil Chamber will be more willing to look at the facts of the case instead of basing their decisions on political factors--several of the 15 judges sitting on the Supreme Court are FMLN partisans. The December 7 decision, meanwhile, may itself have been tainted. Local counsel suspects that Bukele may have influenced the Second Court of Appeals judge through their common membership in a local evangelical church headed by Edgar Lopez, who pleaded guilty to passport fraud earlier this year in Texas.

¶5. (U) This case is but one of three pending lawsuits involving McDonald's and Servipronto. McDonald's filed the second case against Servipronto in June 1996, seeking closure of Servipronto's Metrocentro outlet. The Second Mercantile Court is currently hearing the case--the Second Court of Appeals and Civil Chamber of the Supreme Court have already heard it, but it was remanded to the court of first instance on technicalities. Meanwhile, a court injunction prohibits Servipronto from using McDonald's trademarks at its Metrocentro location. The third pending case Bukele filed in 2002 is against McDonald's current franchisee Servimatic for building a restaurant across the street from a now-closed Servipronto outlet. That case has not yet been heard. In June 2003, the Supreme Court's Civil Chamber rejected Bukele's appeal on a fourth case that McDonald's filed against Bukele to prevent him from using McDonald's trademarks in his restaurants. That case is closed and the verdict enforced (Ref. B).

¶6. (SBU) Comment: The Salvadoran Courts are often an obstacle to the country's economic development. Inexplicable delays and erratic decisions are common. The judicial system is politicized, and FMLN judges in particular have shown a strong bias against U.S. interests in a number of cases. There are numerous allegations of corruption against judges across the political spectrum. The result is an unreliable justice system that often fails to protect the rule of law. Government officials, especially those tasked with promoting foreign investment, have a difficult task in promoting new investments desperately needed to promote job creation. From a policy perspective, the country is "on track," that is, macroeconomic fundamentals are strong, investment barriers are low, and the government provides a generally good investment climate; on most days, it is a good place to do business. However, on those days when things do not go well, and an investor seeks resolution of a dispute with a business partner, El Salvador is not the place to be.

¶7. (SBU) Comment continued: Judicial reform has been until now considered politically impossible, but President Saca's approval rating remains high among the public, and his ARENA party is poised to convert that popularity into additional seats in the Legislative Assembly in March elections (Ref. A). Over the next few years, El Salvador may have an opportunity to push through meaningful judicial reforms, some of which require constitutional amendments, a lengthy process that requires approval by two consecutive Assemblies. Post will continue to encourage President Saca and other decision-makers, especially Supreme Court President Agustin Calderon, to push forward this necessary judicial reform. End comment.
Barclay